

<p>DRAFT PAPER</p> <p>MID-TERM REVIEW OF THE IMPLEMENTATION OF TRADE SECTOR STRATEGY OF THE SIXTH NSED</p>
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1. The 6th NSEDP Trade Sector Strategy, Overall Targets and specific Tasks

1.1 NSEDP Trade Strategy and Overall Targets and Specific Tasks

The Sixth National Social Economic Development Plan (NSEDP), which is the main framework for national development in Laos for the period (2006 - 2010), aims at leveraging trade as one of its many catalyst for growth. The NSEDP recognizes the importance of trade and international integration as a gateway to economic growth and poverty alleviation. The main goals of the NSEDP are to 'accelerate economic growth and improve the people's quality of life; restructure the economy and employment in building a market economy, based on the country's rich resources and international integration; further build the market economy with a socialist orientation and continue to enlarge and develop effective external economic relations'¹. With regard to international integration, the objective is to fully implement the integration roadmap and commitments for the country to become member of international organizations (including WTO) and in multilateral relationships such as AFTA and GMS. The NSEDP sees trade and exports as having a central role for stimulating growth through increasing competitiveness and utilizing comparative advantages to implement effectively international economic commitments in the framework of the ASEAN and other bilateral and multilateral commitments, including WTO. The main pillars of the trade and export strategy for Laos are (i) the expansion and diversification of markets and strengthening the present position in existing markets (ii) increasing market access and (iii) product diversification and quality improvements. The 6th NSEDP Plan (2006-2010) sets the following overall target in the area for Exports and Imports, which serves as a proxy for the expansion of trade and deepening regional and global integration for Laos:

Table 1 – NSEDP Trade Sector Targets		Target (2006-2010)
Export	<ul style="list-style-type: none"> Develop the export of high value-added products and upgrade the quality and quantity of exports through the use of new technologies and skilled labor. Promote the expansion and diversification of markets, while strengthening the present position in existing markets. 	(i) The total exports in the five years would reach USD 3.48 billion, with an annual average growth rate of 18.1 percent. (ii) Export growth increased from annual average 8.6 for the period (2001-2005) to 18.1 for the period (2006-2010)
Imports	<ul style="list-style-type: none"> Prioritize imports of materials and equipment for industrialization to enhance the competitiveness of locally produced commodities in the domestic market. 	(i) The import turn-over in the five year period is estimated to be USD 4.5 billion, increasing on average at 8.8 percent per annum. (ii) The trade deficit in the five-year period 2006-2010 is projected to be about USD 1.02 billion, which is equivalent to 29.3 percent of total export turn-over, or 5 percent of GDP (as compared to 8.4% of GDP in 2005)
Patterns of Trade	<ul style="list-style-type: none"> Asia will continue to be a focal market for Lao exports. The emphasis will be on focal markets, such as the ASEAN; China, Japan, Taiwan and Korea; the EU, Switzerland and Russia in Europe; Australia; the U.S.; and South Africa. 	Exports to the following markets are expected to reach: <ul style="list-style-type: none"> Asia 55-60% EU market reach 28-30 percent; Australia to 10-12 percent; USA and Africa to 3-4 percent.

Source: 6th NSEDP

¹ Lao PDR: National Socio Economic Development Plan (2006-2010)

At a sectoral level the NSEDP identifies the key export sectors for Laos as being:

- **Agriculture, forestry and aquatic products:** The growth of exports in this sector is estimated to be 13 percent per annum during 2006-2010.
- **Coffee generates significant export revenue.** The growth of exports in this sector is estimated to increase from 3-4 percent to 8 percent per annum.
- **Wood and wood products:** It is estimated that, in the coming years, the export of these products will grow at 7-9 percent per annum.
- **Light industry and handicrafts** (textiles and handicrafts). The export turnover of textiles is projected to increase by 5 percent on average during the next five years.
- **Raw Materials, Energy and Minerals:** By 2010, this sector will account for 44.6 percent of the total export turnover. The main commodities are electricity and minerals (gypsum, gold, etc.), which have rather stable export capacities and play an important role in Lao exports. Electricity export turn-over is planned to grow at a rate of 18-25 percent per annum, especially in the latter years of the Sixth Plan (2006-2010). Whilst the mineral sector exports are projected to grow by between 18 and 20 percent per annum during 2006-2010.

Based on the overall goals to be achieved in the trade sector and the set target indicated above, the NSEPD identifies a number of tasks, to be implemented over the 4-year period. The table below captures some of the key tasks, which are directly related to the Trade Sector.

Table2 : Summary of main tasks for the Trade Sector as laid out in the 6th NSEDP

Outcome	Tasks
Restructure the economy and employment and accelerate in the direction of improving effectiveness and bring into play the comparative advantages of goods, sectors and regions.	This is to be accomplished through improvements in quality, effectiveness and competitiveness of each commodity and enterprise, and the economy as a whole
Develop the multi-faceted economy, with the public sector playing a decisive role in facilitating the development of all businesses, including household businesses and domestic private, foreign and collective enterprise, to improve the market economic mechanism with a socialist orientation	<ul style="list-style-type: none"> • Creation of a fair, transparent, stable, open and highly competitive environment for private investment and business; • Encourage the development of the network of small and medium enterprises to increase domestic resource mobilization, investment, economic output and employment.
Expand and improve foreign trade, with a favorable environment created for the growth of exports, and attract investment and technology from abroad.	Actively integrate into the international economy, on a cautious but effective schedule, implementing bilateral and multilateral commitments at national, local and business levels;
Extend bilateral and multi-lateral agreements and fully implement the integration roadmap and commitments for the country to become a prestigious member of international organizations (including WTO) and in multilateral relationships such as AFTA and GMS.	<ul style="list-style-type: none"> • The institutions and capacities of GOL staff will be adjusted and strengthened to meet the modernization requirements and to comply with the WTO regulations. • Formulate and improve the draft laws with respect to mutual development. • Increase the quality and competitiveness of each product; and create brand names to compete effectively as the protection barriers are removed. • Formulated of an overall plan and a road map with proper time lines, which will promote the implementation of CEPT/AFTA • Actively negotiate to gain accession to WTO during the Plan period.

1.2 Implementation of the Trade Strategy and the IF Process in Laos

Based on the overall trade strategy, targets and tasks laid out in the NSEDP, the Ministry of Industry and Commerce (MOIC), has prepared a number of key documents which flesh out in detail the required policy reforms and accompanying Trade Related Assistance, which will be required for implementing the NSEDP Trade Sector Strategy.

The National Export Strategy (NES) and the Diagnostic Trade Integration Study (DTIS) are two main frameworks put together by the MOIC to guide the implementation of the NSEDP Trade Strategy. The NES is a cluster study, which covers the following sectors namely - tourism, garments, medicinal herbs, organic (agricultural) products, silk, handicrafts and wood products. A complementary and more detailed analytical study, the DTIS was undertaken by the by the Ministry of Industry and Commerce and Development Partners (DP) through the Integrated Framework Process. The DTIS further refined the GOL trade strategy and goals and translates these goals into a comprehensive and flexible Action Matrix which lays out a series of Trade Related Assistance and policy reforms to be undertaken by the GOL. The DTIS and its Action Matrix were validated during the National Validation Workshop in September 2006, following extensive stakeholder consultations. The DTIS identified five priority areas for development assistance for Laos:

- Export Competitiveness,
- Trade Facilitation,
- Business Environment,
- Trade Policy, Trade Agreements and Global Opportunities,
- Trade Opportunities for the Poor

Within these five priority areas, a number of projects have been identified under the Action Matrix. Over the last 2 years a number of important trade related projects have been initiated by mainly the Ministry of Finance, Ministry of Industry and Commerce, Ministry of Communication Transport Posts and Construction (CTPC) and Ministry of Agriculture and Forestry, in partnership with key DP. With the growing importance of Aid for Trade, there has been a marked increase in the amount of ODA being channeled or committed to the area of Trade in Laos, which underlines the urgent need for stronger inter-agency coordination and government/donor coordination.

The MOIC with the support of the IF Donor Facilitator have through the IF process further refined the GOL trade implementation strategy and set up mechanisms for effective management and coordination of Trade Related Assistance (TRA). The MOIC is in the process of establishing a permanent National Integrated Framework Governance Structure (NIFGS), a multi-agency entity consistent with the WTO Integrated Framework (IF) and the Vientiane Declaration on Aid Effectiveness, which will coordinate Official Development Assistance (ODA) in Trade sector. This will permit a more coherent, effective, and participatory implementation of the comprehensive reform plan spelled out in the Action Matrix (reviewed on a multi-annual rolling basis), synergistic increase in benefits from ODA, and a reduction of the transaction costs incurred with stand-alone development partner assistance. Development partners in future are expected to consider contributing to the GOL medium-term priorities via NIFGS.

Based on lessons of experience, NIFGS is designed to:

- a) avoid small uncoordinated projects, which have high transaction costs both for the Government and development partners;
- b) ensure full involvement of beneficiaries and stakeholders in the design of trade-related interventions;
- c) align all activities with the Government's existing structures, building ownership and reducing burdensome administrative requirements;
- d) permit reasonable flexibility to adapt to changing circumstances;
- e) permit medium to long-term engagements permitting a strong focus on capacity building and strengthening skills, and
- f) permit transparent and accountable monitoring and evaluation consistent with the objectives established in the IF Action Matrix.

The Government, under the NIFGS will identify and implement the program in the IF Action Matrix, according to the following principles:

- a) Align development partners support with the multi-year work plans as presented in the regularly updated by GOL Action Matrix for Trade-Related Assistance;
- b) Clearly identify and account for programs/interventions that development partners will support either through the Multi Donor Trust Fund or outside;
- c) Streamline reporting and monitoring for government and development partners increasing flexibility and reducing government and donors' transactions cost; and
- d) Provide a multi-year predictable development partner support commitment to the government-led trade reform.

Three key concrete steps have been initiated by the MOIC in view of operationalising the NIFGS and implementing the Trade Strategy of the NSEDP:

Set up of IF Task Force: Building on the IF Secretariat, the MOIC has set up a governance structure for TRA which focuses on refining the IF Secretariat into technical taskforces based on the key components of DTIS. These inter ministerial Task Forces are critical for ensuring effective and coordinated implementation of the NSEDP Trade Strategy across Ministries, government agencies and specific sectors. The IF Task force will be responsible to provide guidance to the MOIC and key line ministries on technical and policy direction in a given trade related sectors. It is foreseen that the IF Task Force will be responsible to **ensure that the outcome for specific sector is reached** and these will be used to provide technical support for implementing all projects under the IF Action Matrix. (Annex 1– Composition of the IF Task forces)

Set up of IF National Implementation Unit:

To assist in the coordination of the implementation of TRA the MOIC has set up in September 2007 the IF NIU whose key role is to ensure coordination at all stages of the IF process of the national stakeholders, including government, private sector, and civil society. The NIU will be responsible for operationalising the DTIS Action Matrix and it will be the main operational body, which coordinates the implementation of Trade Related Assistance, coming from Multilateral, bilateral and regional funding. The NIU key role is to work with government line ministries and agencies in translating the identified actions in the DTIS Action Matrix into bankable and feasible projects.

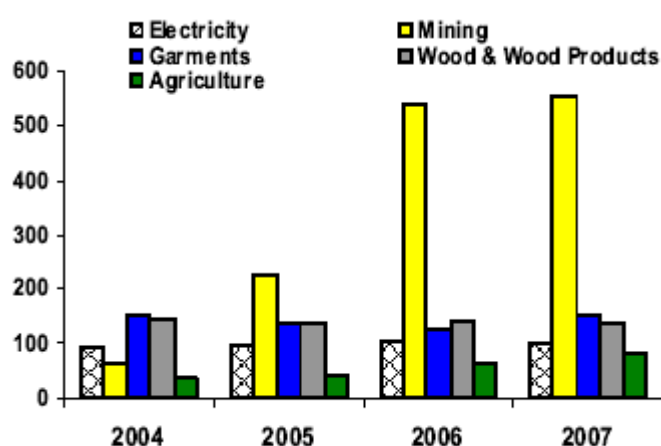
Set up of a Sub-Sector Working Group on Trade and Private Sector

The Trade and Private Sector Sub-working group (TPSSWG) aims to strengthening government donor coordination in the area of Trade. The Ministry of Planning and Investment, together with the MOIC have agreed to set up the TPSSWG under the Macroeconomic and Private Sector working group. This TPSSWG aims at (i) Improving the effectiveness of Policy dialogue in the area of Trade and Private Sector (ii) Improving Coordination, Harmonization, Simplification and Alignment Efforts. The key tasks of the TPSSG will be to *ensure government leadership and ownership over key strategic issues in the area of Trade and Private Sector and provide a common policy and programming framework for GOL and DP*. The first meeting of the sub-sector working group is planned for August 2008.

2. ACHIEVEMENTS AGAINST THE TARGETS OF THE TRADE SECTOR IN THE 6TH NSEDP

2.1 OVERVIEW IMPORT, EXPORTS AND TRADE PATTERNS AND DIVERSIFICATION

According to the recent World Bank Economic Monitor for Laos real GDP growth is estimated at 7.5 percent in 2007 and projected to rise to 7.9 percent in 2008. These figures are in line with the set target of the 6th NSEDP, which projects a 8.2-9% GDP growth rate by 2010. Under the 6th NSEDP, the GOL projects that the growth rate in industry will be considerably accelerated due to increased industrial opportunities, especially hydropower dams and cement factories. Out of the 7.5% GDP growth rate, new hydro and mining projects are expected to only contribute around 2.5 percent of this growth, including from construction of four hydropower dams and a large copper plant. The remaining 5 percent is expected to come from investments in plantations for agricultural crops and industrial forestry, steadily rising tourism revenues, and newly emerging food and non-foods processing industries. Laos has also benefited from rising raw material export prices. Lao key raw material exports include metals (mainly copper, gold and tin), rubber, sugar and other agro-industrial products. The key target sector of the NSEDP namely agriculture, forestry, coffee, wood and wood products have also shown signs of expansion. In the last two years, production and exports of Lao agricultural products (maize, coffee, rice, fruit and vegetables) increased due to growing demand from neighboring countries.



Based on the data below we can see a more than four-fold increase in export of natural resources. The mining sector (especially copper, grew by almost 9 percent in 2007. Export growth was driven by agriculture (mainly coffee and maize) and garments, with both of these industries increasing by over 20 percent. The export of electricity and wood products declined marginally whilst gold exports dropped by over

20 percent due to a significant decrease production in 2007. The Table 3 below shows the trend in exports and imports over a 4-year period.

Table 3 – Export and Imports for Laos 2004-2007

	2004	2005	2006	2007
Exports (mil. US\$)	500	648	1,029	1,053
Agriculture	36	42	65	80
Coffee	15	8	13	31
Other crops and livestock	18	30	45	46
Non-timber forest products	4	4	7	3
Natural resources	149	308	631	635
Electricity	91	105	104	99
Mining	58	203	527	536
Manufacturing	300	275	266	291
Garments	155	138	126	153
Woods and wood products	145	137	140	138
Other	16	21	67	48
Imports (mil. US\$)	958	1059	1397	1969
Food products	24	28	40	55
Fuel	95	175	201	250
Resource imports	232	358	431	897
Other investment goods	287	273	344	308
Other consumption goods	157	68.3	223	251
Raw materials and intermediate goods	163	157	157	208

Source: Lao authorities and partner countries and staff estimates

The 6th NSEDP also foresees that over the five-year period (2006-2010) exports would reach USD 3.48 billion, with annual average growth rate of 18.1%. Whilst total imports in the next five years is projected to reach USD 4.5 billion, with an annual average growth rate of 8.8%. Based on the World Bank data in 2007 total export stood at approximately USD 1 billion that is a little less than a third of the projected total exports to be reached by 2010. Total exports from 2005 to 2007 increased by approximately 60%. Imports have also been growing steadily as shown in the table below. This increase is largely driven by increased investment imports for large resource projects (with mining and hydropower accounting for about 45 percent of total imports), agriculture (plantations), processing industries, trade and services. Capital imports grew quickly by about 50 percent and constituted almost 70 percent of total imports last year. Imports of raw materials increased by almost 30 percent and consumption products increased slightly. The import trends are also in line with the NSEDP set import targets, which are summarized in Table 1 – NSEDP Trade Sector Targets.

Balance of Payments and Trade	(US\$ millions)		
Exports of goods (fob)	648	1,029	1,053
Imports of goods (cif)	1,059	1,397	1,969
Exports of goods and services	870	1,269	1,327
Imports of goods and services	1,120	1,466	2,046
Net trade in goods and services)	-250	-197	-719
Current account balance (% of GDP)	-11.7	-8.8	-19.1
Non-resource current account (% of GDP)	-9.7	-7.1	-8.3
Reserves, including gold	238	335	539

The structure of the economy is projected under the 6th NSEDP to show a contraction in the agricultural sector, and an expansion of the Lao industrial base, with a very slight increase in the Services sector.

Table 4 - 6th NSEDP Projected Structure of the Economy (2006-2010) (percent)

Sectors	2005-06	2006-07	2007-08	2008-09	2009-10
Agriculture	43.1	41.3	39.6	37.8	36.0
Industry	29.9	31.4	33.0	34.6	36.4
Services	27.0	27.3	27.4	27.6	27.6
GDP	100	100	100	100	100

The World Bank Economic Monitor, show that in 2007 the agricultural sector stood at 40.4% of GDP, contracting from 44.3% in 2005. Industry as a % of GDP rose from 30% in 2005 to 34.1% in 2007 and Services remained constant at 25.6% over the same period.

With respect to trade patterns, Asia remains the major export market for Laos. The key export markets included Thailand, Vietnam, Malaysia, China, Australia and the EU. The share of Lao exports to Thailand decreased markedly in 2007 (down from about 50 percent in FY2006 to around 30 percent). Exports to China and Vietnam increased rapidly (from 11 to 16 percent to Vietnam and from five to 11 percent to China). Recently, Lao exports to the US have increased, but the overall value is low (just over 1 percent of total exports). Most imports to Lao still come from ASEAN countries (about 68 percent from Thailand and 13 percent from Vietnam), China (7 percent), EU (3 percent) and the rest economies (about 9 percent).

Table 4 - Export by Destination Country 2007 compared against NSDEP Target 2010

Export by Destination country 2007	NSEDP Targets for Export Markets by 2010
Asia 69%	Asia 55-60%
EU 13%	EU 28-30
US 1%	US and Africa 3-4
Australia 8%	Australia 10-12%

Overall the import and exports have been performing within the set parameters of the NSEDP. However based on available data it is not possible to estimate the level of value addition and it is likely that commodity such as coffee, wood and mining are exported with minimum processing. With respect to promoting value addition in the wood and wood product sector a PM Order No 31 dated August 23, 2006 which aims to protect national forest, fight illegal logging and promote value addition to the sector. However this decree has raised a number of issues for small and medium size workshop and the handicraft sector, with respect to the minimum level of equipment and scale specifications stipulated by this decree.

It is important to note here, in the absence of complete data, that informal cross border trade in Laos is large. It is estimated that more than 50% of the Lao population now lives in border districts and most of informal trade moves across land borders and Mekong River. Given its significance it would be important to assess implications of informal trade on national revenues and its socio-economic impacts.

2.2 TRADE REFORMS AGENDA AND KEY ACHIEVEMENTS

The 6th NSEDP lays out the overall framework for GOL trade reform agenda, which hinges on:

- Improved business and investment climate
- Legislative and legal reform and compliance with WTO regulations

The trade reform agenda has subsequently been refined and fleshed out in the DTIS. The focus of the reform agenda in the area of Trade (Annex 2 Summary of Policy recommendations from DTIS) is summarized in the table 5 below:

Making Trade Easier	Making investment and doing business easier
<ul style="list-style-type: none"> • Regulation and taxation of trade • Trade logistics and facilitation • Streamlining customs • Sanitary and Phytosanitary Procedures (SPS) 	<ul style="list-style-type: none"> • Fiscal management • Banking system Development

A number of trade related assistance projects are currently supporting the GOL reforms in customs, SPS, and trade facilitation. The Poverty Reduction Support Operation, (PRSO) which is a series of annual operations to support policy reform in Lao PDR and which provide resources directly into the government's budget is closely aligned with the Lao 6th National Socio-Economic Development Plan (NSEPD) and support the GOL reform agenda by focusing on:

- (i) Strengthening investment climate, competitiveness and business development;
- (ii) Improving public finance, capacity and resources management.

The PRSO supports a frontier of reforms in trade-related areas, namely measures to reduce trade barriers and implement international and regional agreements include: (1) revising Customs law and developing relevant implementing regulations and guidelines, (2) developing and implementing national trade facilitation action plan aimed at promoting simplification, harmonization, transparency and automation in customs and other border procedures.

With respect to the reform and progress achieved in the areas of trade and investment, numbers of regulations, decrees and laws have been enacted over the last 3 years, with a view to supporting the GOL reform agenda. Below are some of the landmark laws, decrees and reforms, which have been undertaken or in the process of implementation:

- Adoption of Laws such as value added tax, budget law and labor law, the Enterprise Law.
- Finance: a Commercial Bank law was passed in December 2006; Amendments expected soon on regulations on managing foreign exchange and precious metals
- Forthcoming laws and regulations, aiming to be compatible with the WTO e.g. national treatment and non-discrimination among its members including on: import and export procedure, pricing, investment, foreign exchange, veterinary regulations, value added tax, standards, and intellectual property
- Trade policy: a revised shorter list of export-import goods subject to control or prohibition (October 2006), tariff cuts under the ASEAN Free Trade Area and work with ASEAN members on non-tariff barriers
- Laos has joined the World Customs Organization, and adopted a decree to implement the new Customs Law.

- Regulations to improve trade facilitation and more streamlined import and export procedures
- Intellectual Property Law

Key reforms in the pipeline also include the implementation of the Value Added Tax (VAT), which is currently planned for October 2008. The main challenge in the area of legal and regulatory trade reform lies in the implementation of these laws as well as the proliferations of decrees and decisions by government line agencies.

In terms of the impact of the on-going reforms being undertaken by the GOL, it may be still early to make a thorough assessment of the impact of the package of reforms which are being implemented in the area of trade, investment and private sector. However in the area of trade facilitation, logistics and business climate, the data available from a recent time release study undertaken by the World Bank and the 2008 International Finance Cooperation (IFC) report, 'doing business in Laos' provides some gauge on the progress achieved in these areas to date. According to the Logistics Performance Index (LPI), Laos has been doing fairly well on logistics compared to various aspects of investment climate. The country ranked 117th out of 150 countries on the 2007 LPI. Its weakest logistics indicators are tractability of shipment (1.89 on the scale of 1 to 5) and quality of transport and IT infrastructures (2.0). The same study rates Lao PDR at 120 out of 150 countries on efficiency and effectiveness of Customs and other border procedures. Laos compares unfavorably to the average East Asia and Pacific or low income country in most aspects related to the investment climate. It ranks 164th of 178 on the 2008 Ease of Doing Business Rank and 158th of 178 on the 2008 Doing Business – Trading across borders indicator. This is mostly due to very long import and export processing times. A large portion of the economy is informal involving unrecorded cross-border trade activities.

Table 6 – Ease of Doing Business 2008

Ease of Doing Business	Doing Business 2008 rank	Doing Business 2007 rank	Change in rank
Doing Business	164	166	+2
<u>Starting a Business</u>	78	76	-2
<u>Dealing with Licenses</u>	111	108	-3
<u>Employing Workers</u>	82	81	-1
<u>Registering Property</u>	149	147	-2
<u>Getting Credit</u>	170	170	0
<u>Protecting Investors</u>	176	175	-1
<u>Paying Taxes</u>	114	112	-2
<u>Trading Across Borders</u>	158	168	+10
<u>Enforcing Contracts</u>	111	110	-1
Closing a Business	178	178	0

Source – Ease of doing business International Finance Cooperation (IFC)

Whilst Laos' logistical services have been improving, it is still behind neighboring countries - Vietnam and Cambodia. However it is expected that through on-going efforts of the GOL to modernize customs and improve trade facilitation, its logistics performance is likely to gradually improve. A number of important TRA projects are currently supporting the reform process in the above areas and a number of new projects are also in the pipeline (Annex 3 – TRA Donor Matrix for Laos). The main donors engaged in this area are the ADB, Australia, and European Commission.

2.3 INTEGRATION IN THE REGIONAL AND MULTILATERAL TRADING SYSTEM

Laos' major market reforms have been spearheaded and motivated by its ongoing WTO accession as well as its commitments taken in the context of ASEAN and all these contributes in improving Laos' competitiveness and its ability to integrate the international trade system. The WTO accession can be an effective lever to promote trade liberalization and substantive regulatory reform. These reforms and policy shift have been articulated in the Laos 6th Five-Year National Socio Economic Development Plan (NSEDPP).

The GOL continued to make progress on WTO accession negotiations, the third working party was held in Geneva in November 2007. The GOL/MOIC updated the legislative action plan and discussed the Initial Offer for services with negotiating partners during the working party meeting. Work on formal responses to the questions raised by bilateral and multilateral negotiating partners are ongoing. In July 2008, the 4th Working party will convene in Geneva where a second services offer and revised goods offer will be tabled.

Key Milestones:

- To date two rounds of bilateral market access negotiations have been completed.
- Over a 4-year period, Laos has held three working party meetings: the first in October 2004, the second in November 2006 and the third on 15 November 2007 and the next is scheduled for the 4th July 2008.
- Laos submitted the replies to three sets of questions as well as checklists and legislative action plans on agricultural subsidies, customs valuation, sanitary and phytosanitary, technical barriers to trade, and intellectual property. In 2007, Laos added an offer on services to the one on market access for goods submitted a year ago, along with more details on the reforms it is undertaking.
- A factual summary of the points raised was also discussed at the third Working Party Meeting. This document forms the basis of what will be the 'draft working party report' and eventually the final agreement as a protocol of accession.

In the context of ASEAN, Laos in 2007 endorsed the ASEAN blueprint for an integrated Southeast Asian Economic Community. This is a master plan that will guide ASEAN members achieve an ASEAN Economic Community (AEC) by 2015. According to the Blueprint, the AEC builds on four pillars: a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy. It is expected according to the Blueprint that by 2015, there will be a free flow of goods, services, investments and skilled labor, and a freer flow of capital, with equitable economic development and reduced poverty and socio-economic disparities. The AFTA Common Effective Preferential Tariff (CEPT) which Laos started implementing in 1998, is expected to reach 0-5% by 2008. Laos is also engaged in the implementation of the ASEAN Framework Agreement in Services (AFAS). The main objective of AFAS is to liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken by Member States under the GATS with the aim to realizing a free trade area in services. Laos is set under AFAS to meet the free flow of services by 2015. Laos under the USA BTA has made commitments in 12 sectors and 70 sub-sectors. Laos faces the potential challenge in the overlap of the three services trade agreements and of reconciling its commitments particularly between the US BTA and its GATS commitments.

The main challenges for the GOL with respect to its ongoing trade negotiations and

its current and future commitments at multilateral, regional and bilateral level is – capacity to effectively prepare and negotiate; to ensure that the commitments undertaken in the various negotiations are commensurate to its level of development; that the various commitments are coherent; and that the government and private sector are equipped and capable of implementing its commitments. Laos has revived under various TRA programs, technical assistance to support the preparation of trade negotiations.

3. KEY TRADE RELATED REFORM AND PROJECTS

Trade related assistance has been increasing steadily in Laos over the last five years. The project and programs which are currently being implemented or in the pipeline are closely linked to the identified priority activities identified in the NSEDP and support the main goals and trade reform agenda of the GOL. While there is no accurate estimate of how much ODA flows to Trade Related Technical Assistance (TRTA) and Capacity Building (CB) in Laos, the OECD TRTA and CB database gives an estimate of US\$ 79 million (this figure includes US\$30 million for infrastructure). Excluding infrastructure TRTA over a six-year period, spanning 2001-2007, is estimated that around US\$ 49 million². In the next 2 years based on the projects in the pipeline it can be roughly estimate that a total of grants in area of TRA will be around US\$ 20 Million. A number of key projects currently in the pipeline:

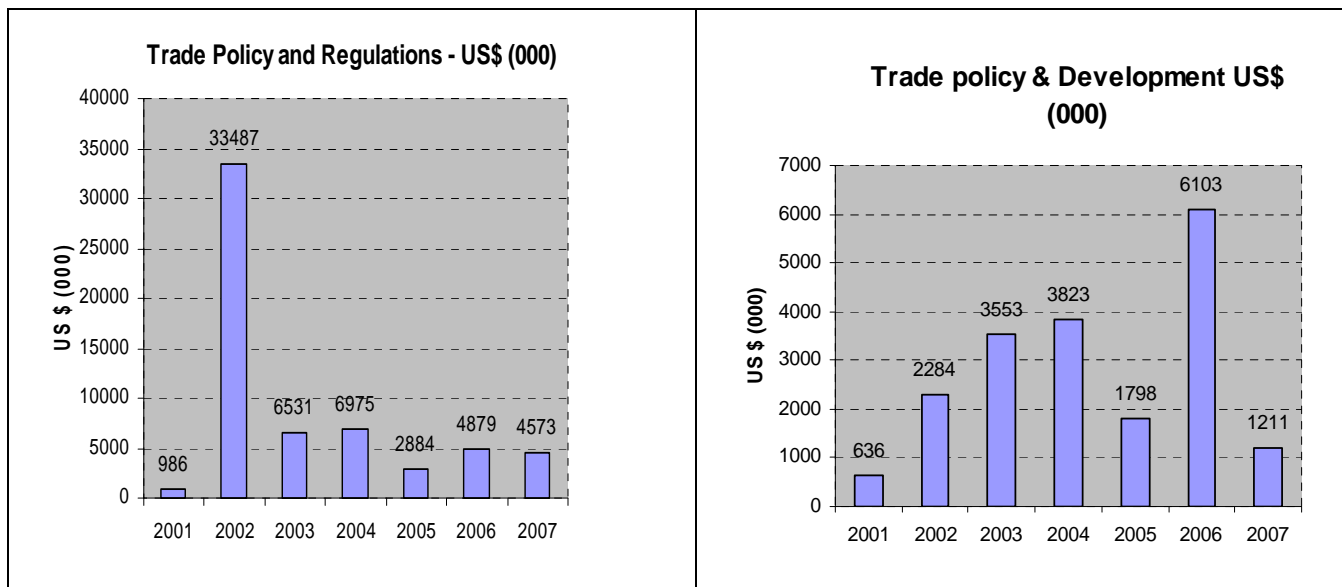
- The Trade Development Facility (TDF) a multi donor trust fund being set up by the EU and AusAID – (6.45 Million US\$ⁱ)
- The Lao Customs Trade Facilitation Project – World Bank (4 Million US\$ⁱⁱ)
- The Enhance Integrated Framework – Global Trust Fund (approximately 4-6 Million US\$)
- Trade Promotion Support programmes – JICA (1.5-2 Million US\$)
- Poverty Reduction Support Operation (PRSO) – Budget Support

In the area of Trade Infrastructure the ADB and Japan are the most active donors, investing in road infrastructure and airports, in the form of grants and loans. The ADB is also the lead donor in the area of support to the implementation on agreement on GMS cross-border movement or bilateral arrangements through the Greater Mekong Subregion Cross-Border Transport Agreement (CBTA) and Support to Trade Facilitation and Capacity Building in GMS programs. Under CBTA the single stop inspection has commenced along the Dansavanh and Lao-Bao border, single window inspection at Savannakhet and Mukdahan border, and the Government of Lao has been actively involved in the discussion/negotiation of the GMS customs transit system, which is expected to enter into operation along the selected EWEK route this year. ADB supported gap analysis on customs, SPS, trade logistics among the GMS countries with aim to pursue stronger SPS collaboration among the GMS countries, and development of national logistics action plan, as well as support of Customs Director General meetings.

²This excluded the recent Window II funding

Table 7 – TRA in Lao PDR

	Trade Policy and Regulation ⁱⁱⁱ US \$	Trade Development US \$	Grand Total
2001	986,000	636,000	1,622,000
2002	*33,487,000	228,400	35,771,000
2003	6,531,000	3,553,000	1,008,400
2004	2,884,000	3,823,000	1,079,800
2005	2,884,000	1,798,000	4,682,000
2006	4,879,000	6,103,000	10,982,000
2007	4,573,000	1,211,000	5,784,000
*including infrastructure			79,729,000



WTO/OECD Database

The TRA activities are closely linked to the DTIS action matrix and focuses on: (i) Trade Facilitation, (ii) Customs Reform, (iii) SPS (iv) Trade Promotion (v) Strengthening of business environment and (vi) Capacity building and training in the area of Trade negotiations. As mentioned above it is difficult based on the OECD/DAC data to get a precise gauge of the amount of ODA being channelled to TRA in Laos. There are issues related to underreporting in some cases as well as reporting of regional projects, which distorts the data on TRTA/CB. However the attached TRA Donor Matrix does help provide a closer picture of the state of ODA on the ground.

3.1 KEY DONORS INVOLVED IN TRA IN LAOS

Based on the OECD/DAC database the top five donors in Laos are **ADB, WTO, EC, Japan and Switzerland** (see table 3 below). When compared to the Donor Matrix, which has been compiled, by AusAID and UNDP, we find that the key donors in Laos (Grants) are AusAID, ADB, Japan, EC, Switzerland (SECO) and USAID,.

Table 8 – Summary of TRA by donors

Summary Table TRA for Laos 2001 - 2007(OECD DAC Database)		
	US\$	%
Asian Development	30,150,000	38
WTO	18,564,000	23
EU	5,719,000	7
Japan	4,380,000	5
Switzerland	4,376,000	5
France	4,168,000	5

Over the last 5 years there is a clear pattern of increasing number of new projects, volume of ODA flowing to TRA and donors involved in the area of Trade. This new trend presents both challenges and opportunities for the GOL in implementing its Trade Strategy as laid out in the NSEDP.

4. Challenges and Constraints

Aid Absorption Capacity

The absorption capacity for aid in developing and least developing country tends to be directly correlated with the effectiveness of the development partners' aid delivery mechanism in place, the technical and project management skills of government officials and the private sector and the country's institutional capacity and infrastructure. The way in which aid is delivered is as important as the amount of aid being delivered. The MOIC faces major challenge in the face of raising ODA and increasingly number of donors involved in TRA. The use of innovative aid delivery mechanisms such as the Trade Development Facility (which is a multi-donor trust fund) can go a long way, as discussed in section 1.2 above, in building a country's absorptive capacity and governance system and can contribute to improving government and donor coordination, in line with the principles of the Vientiane Declaration on Aid Effectiveness.

Coordination and Harmonisation of AFT

Responding effectively to the GOL identified needs in the area of trade adjustment will require a collaborative effort from the development partners. Government/Donor coordination and harmonisation of procedures and systems of aid delivery is critical for ensuring that the GOL is able to effectively manage AFT and reap the maximum benefits from AFT. The MOIC has initiated a number of institutional reforms and has set up the NIFGS, as the 'Aid Delivery System' for channelling all AFT managed by the ministry. However the readiness and willingness of DP to use this system and adapt its process and structures is still quite low.

Multilateral and Regional Trade Negotiations

Becoming a WTO member confers a number of advantages. However, the challenges, which a small land lock country like Laos faces as it prepares to become a member of the WTO should not be underestimated. The accession process of the WTO is onerous for the LDCs that lack the human resources and technical capabilities required by the process. The reform process puts pressure on the already scarce resources of the Lao government and the cost of compliance to WTO rules and regulations.

Newly acceding countries like Laos are increasingly asked to set their tariff bindings at levels below the ceilings agreed to during earlier Uruguay Round trade negotiations. In other words, recent WTO members have had to open their markets more fully to imported goods than did earlier entrants into the multilateral trading system. This has serious implications for local labor markets, especially in industries that must compete with imported goods and services in the local marketplace and this is particularly problematic for a country with a weak industrial base such as Laos. Tariff reduction also has important fiscal ramifications. The tax base in LDCs is usually narrow, relying heavily on import taxes and duties, and reducing tariffs can seriously impair government's national budget and its capacity to finance its social expenditure. The GOL in anticipation of revenue losses, which it will incur, both through ASEAN tariff reduction commitments and those that will kick in upon accession to the WTO has introduced Value Added Tax in 2007. However the ability to implement and monitor the implementation of the VAT and other regulatory reforms remain a challenge for the GOL. Inter-agency and ministry coordination at central and provincial level remains a challenge in areas such as SPS and customs reform and tax reforms.

It is important to note that the possibility of revenue losses because of tariff reductions should be fully assessed. In other countries the real impact has been low, mainly because acceding countries were requested to reduce only peak tariffs with no significant impact on overall revenues' collection. In any case, it has been demonstrated that a robust trade facilitation system will support the country's ability to extract revenues from import/export activities. The current customs and trade facilitation reforms in Laos is likely to offset any possible loss deriving from tariff reductions, if they will be implemented according to plans .

Service and Trade in Service

The GOL trade strategy needs to place rather focus on investment of services sector and reforms and liberalization in trade in services. The international negotiations have up to now focused on goods and tabling schedules of tariff commitments at the WTO. The last two working parties have recently been working on the GATS. The NSEDP covers the key services sector of the Lao economy, but remains silent as to the targets to reach in the services sector and the role of services in promoting growth and poverty alleviation. In fact the projection on the structure of the economy as discussed in section 2.1 shows a very modest expected expansion of the services sector from 27% in 2005-6 to 27.6% in 2009-10.

Studies have shown that for goods reforms, when barriers to trade are removed, foreign-source quantity supplied increases, prices fall and domestic output falls. But in services reform, when the increments to supply occur via mode 3, local output can *increase* because of the rise in foreign investment, at the same time as local prices falling. In economies whose service sectors have been relatively closed to domestic private suppliers as well as to foreign participation, services liberalization has been found to lower prices, with significant welfare effects. Konan and Maskus (2006), for

instance, in a simulation of the Tunisian economy found that gains from services liberalization would be more than three times the magnitude of estimated gains from goods trade liberalization alone³. Opening up of sectors such as financial and telecom, accompanied by the necessary regulatory reform has the potential of increasing the Lao overall competitive and is welfare enhancing in particular for the poor rural sector.

Human resource capacity and Skill levels

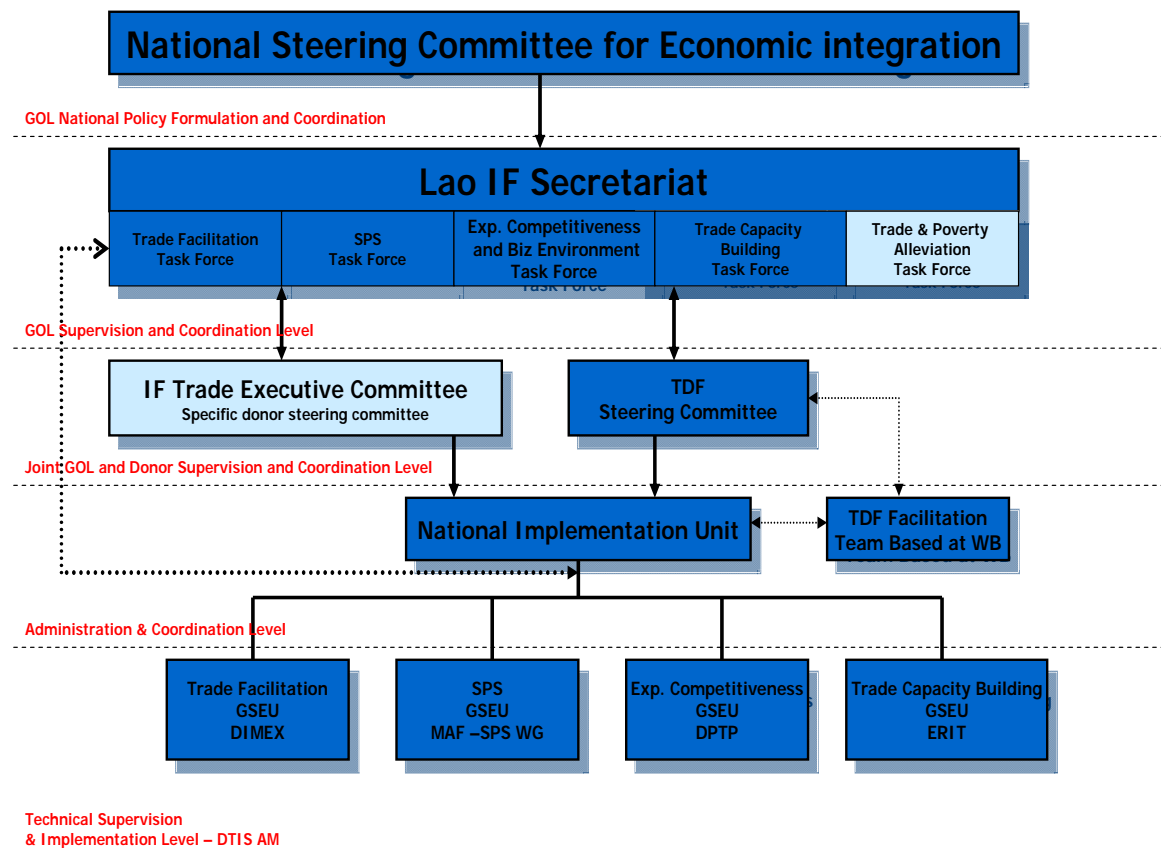
Labor shortages and the quality and level of skills level are two key impediments to Laos's productivity capacity and competitiveness. Sectors such as the garment and textile are facing serious skill shortages, mainly at the factory floor operator levels. There is also a net outflow of labor to neighboring countries. A study conducted by NERI (detail data to be published 2008) has found that the incidence of outward migration in the southern region (around Route 9) is on the rise. This impacts on supply of local labor on the one hand but on the other also provides substantial contribution to the economy via remittances.

Access to Finance and Technology

Access to finance remains one of the main supply side constraints faced by the Lao private sector when trying to take advantage of market access and expand its export market share. Infusion of technology remains also quite low, which impedes the ability of firms to move into higher value added technology. The main reasons for the difficulty for finance and technology to access Laos are : 1) general business environment; 2) complex and "unfriendly" regulations; 3) market's distortion due to government's subsidies to SOEs, etc.]

³ Konan and Maskus (2006) used a computable general equilibrium model of the Tunisian economy with multiple products and services and three trading partners. Restraints on services trade were defined as those on cross-border supply (mode 1) and commercial presence (mode 3).

Annex 1 - Composition of IF Task Force and NIFGS



1. Trade Facilitation:

Lead Agency:

Members:

Import-Export Department, MOIC

- Foreign Trade Policy Department, MOIC
- Customs Department, MOF
- Department of Intellectual, Standard and Methodology, National Authority of Science
- Consul Department, Ministry of Foreign Affairs
- Economics Department, Ministry of Foreign Affairs
- Planning Department, Ministry of Agriculture and Forestry
- Immigration Department, Ministry of Public Security
- Transport Department, Ministry of Public Work and Transport

2. SPS and TBT:

Lead Agency:

Members:

Planning Department, Ministry of Agriculture and Forestry

- Department of Intellectual, Standard and Methodology, National Authority of Science
- Planting Department, Ministry of Agriculture and Forestry
- Lives Stock and Fishery Department, MAF
- Foreign Trade Policy Department, MOIC
- Food and Drugs Department, Ministry of Health

- Department of Production and Trade Promotion, MOIC
- Lao Agro-Processing Group, LNCCI

3. Export Competitiveness and Business Environment:

Lead Agency: Department of Production and Trade Promotion, MOIC

- Members:
- Foreign Trade Policy Department, MOIC
 - Import-Export Department, MOIC
 - Planting Department, MAF
 - Lives Stock and Fishery Department, MAF
 - Industry Department, MOIC
 - SME Cabinet, MOIC
 - Internal Trade Department, MOIC
 - Secretary, LNCCI

4. Trade Capacity Building:

Lead Agency: Economic Research Institute for Trade

- Members:
- National Economic Research Institute, MPI
 - Law Research Institute, Ministry of Justice
 - Foreign Trade Policy Department, MOIC
 - SME Cabinet, MOIC
 - Economic Faculty, National University of Laos
 - Secretary, LNCCI

Annex 2 – Summary of DTIS Policy Recommendations

Area/topic	Recommendation
Making trade easier	
<i>Regulation and taxation of trade</i>	
Tariffs and taxes on trade	Reduce the number of tariff lines that are subject to the top MFN tariff rate of 40% and reduce number of tariff bands Introduce duty drawback scheme for indirect exporters
Trade licensing system	Dismantle redundant licensing requirements, including annual import/export plans, replace necessary technical regulation with arrangements that do not discriminate between local products and imports
Organic certification	Review options for establishing organic certification body to certify and monitor compliance with international organic standards
Standards	Adopt and implement regional standards for key export crops (coffee, horticulture)
Air transport	Resolve issues concerning Lao Airlines structure and capacity, evaluate the possibility of adoption of open skies policy to enable private an international airlines to service more locations throughout Laos
<i>WTO accession</i>	
Economic analysis	Develop capacity to undertake ex ante evaluations of the implications of implementing WTO agreements.
Trade policy establishment	Consolidate trade policy establishment to improve economy-wide perspective, cross-agency coordination in negotiations.
<i>Trade logistics and facilitation</i>	
Container and freight movements	Simplify procedures for factory-to-port container movements along Vientiane-Bangkok corridor. Develop consolidation service for small freight shipments Negotiate necessary changes in Thai customs and border management arrangements Monitor clearance times and productivity at border crossings
Inland container depot	Establish inland container depot near Lao-Thai border in order to consolidate small shipments
<i>Streamlining customs</i>	
Legislation	Implement new Customs Law, develop policy and procedures manual
Organization	Continue efforts to build a unified national Customs administration, and build on efforts to improve control of field operations through the Monitoring and Control Program
Human resources	Develop a comprehensive human resource development plan, adopt competency based recruitment and promotion policies, implement clear and transparent policies for delegation of authority and accountability
Information and communications technology	Develop comprehensive ICT strategy
Customs valuation	Prepare a transition strategy for adoption of the WTO Agreement on Customs Valuation
Trade facilitation	Streamline clearance procedures and rationalize involvement of other government agencies in clearance processes Build on work under GMS Cross Border Transit Agreement to undertake a review of clearance procedures covering all government agencies
Strengthen enforcement capacity	Strengthen anti-smuggling operations, expand intelligence unit and establish a Customs fraud investigations function, address constraints on post-audit function

Sanitary and Phytosanitary Procedures

Market opportunities and trade requirements	Examine potential SPS requirements in markets for potential/emerging non-traditional agricultural exports, review SPS requirements of trading partners and transit countries to identify WTO inconsistent measures to bring to WTO negotiating table, and review SPS requirements of Laos in light of WTO and AFTA principles
Institutional and legislative framework	Establish joint Enquiry/Notification point at Ministry of Commerce, review existing legal framework and amend to capture SPS roles and responsibilities and coordination mechanisms.
Surveillance	Amend legal framework to incorporate stronger monitoring and control of markets for agrochemicals, initiate data gathering and data base creation on health hazards, plant and animal diseases
Diagnostic capacity	Expand laboratory capacity and relevant capabilities
Emergency response	Amend laws, prepare guidelines and procedures
Risk assessment	Establish core group of risk assessors
Inspection and certification	Identify unnecessary requirements for export and import, simplify and strengthen governance of SPS border procedures

Making investment and doing business easier
Macroeconomic management

Fiscal management	Strengthen tax and customs administration and introduce VAT, to offset revenue loss from implementation of AFTA CEPT commitments. Further centralize control over tax and customs operations in the provinces Strengthen control over provincial treasuries, improve budget planning and execution, and develop a central government cash management system Conduct review of intergovernmental fiscal relations
Banking system development	Improve governance of state banks and find strategic partners for them. Secure passage of amendments to banking law to allow entry of foreign banks on equal footing with domestic banks in the medium to long term. Strengthen prudential oversight of banking system Conduct review of export financing services, and work with financial sector to develop relevant products Facilitate development of financial services for tourists – such as ATMs and credit card facilities

Business environment

Simplify business start-up process	Move away from licensing to a registration system Implement without delay provisions in new investment laws that provide for a one-stop service Simplify requirements surrounding acquisition of company seals
Industrial Processes Law	Repeal the law, or at a minimum review the implementing decree
Labor Law	Review and update labor laws to align with regional standards
SME Law	Review alignment of SME Law and customs regulations
Taxation	Revamp tax policy and administration to reduce scope for tax negotiations and make it easier for firms to meet tax obligations

ⁱ **Trade Development Facility** development objective is to support the establishment of the National Integrated Framework Governance Structure (NIFGS or the SWAP) and implement its initial activities in facilitating trade and cross-border movement of goods and increasing the capacity of the Government to undertake specific tasks related to regional and global economic integration. These activities in turn support the GOL's larger aims of poverty reduction and economic development, as reflected in the NSEDP.

The overarching outcomes pursued are:

- Better trading environment, with simplified bureaucratic procedures including in customs;
- Improved legal and regulatory framework;
- Enhanced general capacity of line ministries and agencies involved in the trade sector;
- Improved private sector's capacity to compete in the international market;
- More effective participation in bilateral and multilateral negotiations;
- Increased competitiveness of Lao PDR products and contribute to the poverty reduction.

The TDF includes the following components:

- Trade Facilitation
- Strengthening of the Sanitary and Phyto-sanitary Standards (SPS) and Technical Barriers to Trade (TBT) Frameworks
- Increasing Export Competitiveness and Business Environment
- Capacity Building, Trade Policy, Trade Agreements and Global Opportunities
- Strengthening of the National Implementation Unit

ⁱⁱ **Customs and Trade Facilitation Project** objective is to facilitate trade by improving the efficiency and effectiveness of customs administration. The project will simplify customs procedures, eliminate duplication and redundancy, reduce transaction costs and time to clear goods, and increase transparency and accountability. In particular, the Project contains: (1) Implementation of an automated customs system ASYCUDA World, including acquisition of equipment, customization and installation including user training of UNCTAD's ASYCUDA system at headquarters and nationwide at international border checkpoints. (2) Customs Modernization Support including capacity building activities to

assist Lao PDR to implement modern approaches to customs administration as well as meeting requirements for WTO membership. In addition, the project includes a long term international Customs Reform and Modernization advisor to provide international expertise in the introduction of new Customs systems and to provide overall change management support including assisting the national management team in quality control and verification.